FILE COPY

IN THE

Supreme Court of the United States

OCTOBER TERM, 1943

No. 130
BESSIE P. DOUGLAS,
Petitioner,
vs.
COMMISSIONER OF INTERNAL REVENUE.

No. 131
BESSIE P. DOUGLAS,
Petitioner,
vs.
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No. 132
ESTATE OF CHARLES H. ROBINSON, NORTHWESTERN NATIONAL BANK AND TRUST COMPANY OF MINNEAPOLIS, JESSIE P. ROBINSON, ET AL., ETC.,
Petitioners,
vs.
COMMISSIONER OF INTERNAL REVENUE.

No. 133
BERNICE B. DALRYMPLE,
Petitioner,
vs.
COMMISSIONER OF INTERNAL REVENUE.

ON WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT.

PETITIONERS' REPLY BRIEF

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The law is settled that the aggregate $53,299.03 received by Mrs. Douglas in annual amounts from 1929 to 1936 was allocated by the Revenue Act, through the combined operations of Sections 23(m), 114(b)(1) and 113(b)(1)(B), to return of capital investment when received. The only issue in the case, if the plain language of the statute be adhered to, is "Was that return of capital conditional or was it permament?" And, if the plain language of the statute be applied, the answer is that the return of capital was permanent. *Section 113(b)(1)(B).* There ends the Commissioner's case.

Not enough emphasis can be placed upon Section 113(b)(1)(B) as specifically stating the mature and considered judgment of Congress as to the *statutory effects* on the taxpayer of having taken the depletion deduction granted by Section 23(m). Reflection upon the words of Section 113(b)(1)(B), which provide that basis shall *in all cases* be reduced by depletion "to the extent *allowed* (but not less than the amount *allowable*) under this Act or prior income tax laws," shows that Congress considered and passed upon the very issue involved in this case. The words used cover all possible cases:

1. Where taxpayer deducts exactly the right amount of depletion.

2. Where taxpayer deducts too little depletion.

3. Where taxpayer deducts depletion deemed excessive.

Where taxpayer deducts exactly the right amount of depletion the statutory terms "allowed" and "allowable" mean the same thing and his basis is reduced to the extent of his deduction.

Where taxpayer deducts too little depletion, his basis is reduced by more than his deduction—*i. e.,* to the extent "allowable."

Where the taxpayer deducts depletion deemed excessive his basis is reduced by the amount of the deduction "allowed" *even though it is subsequently found that he has deducted too much.*

This statute provides very clearly that after depletion has been allowed, and if the statute of limitations bars the Commissioner from disallowing the deduction, and if information is subsequently obtained showing the allowance to have been excessive, the remedy is not adjustment by restoring capital account and by taxing a "corresponding amount" as income. The *statutory* remedy is to continue to treat past recovery as capital and prevent a second recovery of that capital by keeping basis reduced to the extent of prior depletion allowed. Article 23(m)-10(c) insists upon doing exactly what the statute states shall not be done.

The language of Section 113(b)(1)(B) is explicit. No further interpretative data is needed. Yet, when we turn to the committee reports relating to this section they are even more specific in condemning the theory on which Article 23(m)-10(c) is based.

The Report of the Ways and Means Committee of the House with reference to Section 113(b)(1)(B) of the Revenue Act of 1932 contains the following:

> "In subparagraph (B), relating to depreciation, etc., for the period since February 28, 1913, the bill requires that adjustment be made 'to the extent allowed (but not less than the amount allowable)' instead of 'by the amount * * * allowable' as in the prior act. The Treasury has frequently encountered cases where a taxpayer, who has taken and been allowed depreciation at a certain rate consistently over a period of years, *later finds it to his advantage to claim that the allowances so made to him were excessive* and that the amounts which

were in fact 'allowable' *were much less. By this time the Government may be barred from collecting the additional taxes which would be due for the prior years* upon the strength of the taxpayer's present contentions. The Treasury is obliged to rely very largely upon the good faith and judgment of the taxpayer in the determination of the allowances for depreciation, since these are primarily matters of judgment and are governed by facts particularly within the knowledge of the taxpayer, and the Treasury should not be penalized for having approved the taxpayer's deductions. While the committee does not regard the existing law as countenancing any such inequitable results, it believes the new bill should specifically preclude any such possibility."

Report, Ways and Means Committee (1932 Revenue Act) (72nd Congress, 1st Session, H. Rept. 708, page 22).*

The Report of the Senate Finance Committee with respect to this section contains the above quoted matter and, in addition thereto, it contains the following illuminating statement.

"Your committee has not thought it necessary to include any *express provision against retroactive adjustments of depreciation* on the part of the Treasury as the regulations of the Treasury seem adequate to *protect the interests of taxpayers* in such cases. These regulations require the depreciation allowances to be made from year to year in accordance with the then known facts and *do not permit a retroactive change in these allowances by reason of the facts developed or ascertained after the years for which such allowances are made.*"

Report, Senate Finance Committee (1932 Revenue Act) (72nd Congress, 1st Session, S. Rept. 665, page 29).*

In the face of the background of Section 113(b)(1)(B), how can the Commissioner assume to have authority to make retroactive adjustments to the basis for depletion? Where

*Italics added.

Congress states that it wishes to protect taxpayers from such adjustments, that no express provision is deemed necessary, that the statute of limitations bars recomputation of tax for such prior years, why can the Commissioner deem himself authorized to do a far worse and more injurious thing to the taxpaper, *i. e.,* reclassify capital into income, add it back to the base, and then, not recompute tax for prior years, but, instead, throw the whole burden into the teeth of the surtax rates for one year's income?

Depletion, at best, is only a guess. Even with respect to actual royalty on ore mined and shipped the amount of the allowance is never accurate. No one can know the number of tons of ore in the ground. Estimates vary. Unsuspected faults in ore veins show up upon mining. Measurements can only be partial. New information may at any time show previous estimates to have been greatly off. Hence, at no time does the amount allowed agree with the amount of actual extraction. Nor, in view of the underlying purpose of the allowance for depletion, is it important that depletion at all times goose step with production. What is important is that the allowance be so spread over the gross income during the life of the property that the taxpayer be reasonably assured of a return of his investment and that he cannot recover by way of depletion more than the amount of that investment.

> "What is important for the protection of the revenues is that accrual for depreciation be applied only to property that is properly depreciable, that it be stopped when the property is fully depreciated, and that the rate be consistently applied so that the taxpayer cannot choose to take only a little depreciation when he has a little income and a lot of depreciation when he has a large income."
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> *Virginian Hotel Corporation vs. Commissioner* (1943), 319 U. S. 523, 87 L. Ed. 1149, 1154, 63 S. Ct. 1260.

To hold these sums to be income, to have been only an illusory kind of capital, the Commissioner must fly in the face of Section 113(b)(1)(B), of the Committee reports, of the specific prohibition contained in the second sentence of Section 23(m) applicable to a case identical in principle with this case, of the underlying purpose of the allowance for depletion, and, perhaps worst of all, in the face of common sense and justice. And all of this he must do without a single statutory word to sustain him.

Respectfully submitted,

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